

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 02 ISTANBUL 000049

SIPDIS

STATE FOR E, EB/IFD/OMA AND EUR/SE  
TREASURY FOR OASIA - MILLS AND LEICHTER  
STATE PASS USTR - NOVELLI AND BIRDSEY

E.O. 12958: DECL: 01/09/2013  
TAGS: [PGOV](#) [ECON](#) [EFIN](#) [ETRD](#) [TU](#)  
SUBJECT: ISTANBUL'S TAKE ON AK ECONOMICS: ALL ISN'T LOST  
BUT AK ISN'T HELPING

REF: A. (A) ANKARA 160  
[B](#). (B) ANKARA 193

Classified By: Consul General David Arnett. Reasons: 1.5 (b) and (d).

[1](#)1. (C) Summary: Istanbul contacts in the financial and real sectors agree that in its first month and a half Turkey's Ak government "hasn't gotten it" and has done a poor job on economic policy, thereby dissipating much of the goodwill generated by initial perceptions that a single-party government would break the deadlock that has constrained Turkish governments over the past decade. Explanations range from a combination of inexperience, lack of coordination, and inconsistency, to a perception that far from being a unified party, Ak is riven into warring factions with the "populist wing," at least to date, coming out on top. Many believe that all is not lost, however. While pessimists believe that AK will not get it under any circumstances, a not insignificant group believes that with the "road map staring it in the face," economic forces will ultimately compel AK to stick with the program. The failure of Tuesday's treasury auction (ref a) is seen by many as a salutary first warning by the markets, while PM Gul's subsequent budget pronouncements (ref b) have been taken as a sign that at least parts of the government are getting the message. Concern is also widespread about the economic impact on Turkey of an Iraq operation, though most agree that recent estimates are highly exaggerated (one contact quipped that they led him to conclude the "U.S. is planning to attack Turkey rather than Iraq"). End Summary.

[1](#)2. (C) Evaporating Euphoria: In a round of calls on leading bank, real sector, and market actors on Wednesday, January 8, visiting Ankara Econ Counselor and Istanbul Pol/Econ Chief heard a decidedly downbeat assessment of Ak's performance to date. The meetings followed closely on Tuesday's unsuccessful Treasury Auction and overlapped with PM Gul's afternoon budget statement. Akbank CEO Zafer Kurtul noted that positive market sentiment has rapidly dissipated in the face of Ak's expansive spending plans and failure to identify savings to pay for them. Even Ak allies from within MUSIAD (the "Islamic" businessmen's association) conceded that Erdogan's "populist" policies have raised issues for the market, while longtime Ak skeptics at Bender Securities argued that the only possible "method to the madness" of recent government policies was expectation that at the end of the day neither the U.S. nor the IMF would allow Turkey to fail. Optimism lingers in some camps, however. ING Baring's Managing Director John McCarthy, a seasoned Turkey watcher, conceded that AK's "honeymoon is over," but argued that despite its populist tendencies, Ak is "smart enough to see the roadmap and won't tinker too much."

[1](#)3. (C) A Shot across the Bows: All pointed to the failure of the January 7 treasury auction to raise sufficient cash for the Treasury to meet its redemption requirements as an important warning to the government, as even the local "primary dealers" that have supported the market up to now failed to step up to the plate. PM Gul's announcement of tax increases and spending cuts late on January 8 (ref b) was taken as evidence that the message had registered, but Bender's initial reading was that even taken at face value the measures will be insufficient to achieve a 6.5 percent primary surplus goal that Gul reiterated. Bender Chief Economist Emin Ozturk noted too that covering the shortfall forced the Treasury to expend a significant portion of its foreign exchange account at the Central Bank. A similar shortfall in the next auction on January 21, he warned, will deplete the account, leaving no "cushion for the future."

[1](#)4. (C) Embattled Reformers?: The general consensus among those we canvassed was that economic understanding in AK is thin, limited mainly to Prime Minister Gul and State Minister Babacan and their entourages. Deputy Prime Minister Sener

had few admirers among those we talked to, while there was agreement that Erdogan too has "not played a constructive role" on economic policy. Given perceived tensions between Gul and Erdogan, and doubts about how much weight Babacan carries within the government, there was concern about just how effective the reformist bloc could be. Not all judge the situation hopeless, however. McCarthy noted that a recent TUSIAD meeting in Ankara concluded that the organization could work with AK, but would need to "support it to the extent we can" to make up for its lack of depth and credentials.

15. (C) Dangerous Tendencies: Observers also expressed concern that despite public pledges to make a new start, AK may revert to familiar patterns of nepotism and corruption. Bender pointed to anecdotal word that some party functionaries are resigning to create construction companies, presumably to benefit from public tenders, while indications that Interior Minister Aksu's brothers may be appointed to head BOTAS and Turkseker also raised concerns. Bender also pointed to mutual suspicions between AK and ranking bureaucrats and pressure from the AK caucus to put "loyal people" in place as potential destabilizing factors.

16. (C) Growth?: Less consensus existed on the question of where Turkey's economy is now. While the Bank of New York said it has seen no movement, noting that its loan exposure has fallen by 2/3 to just over 300 million USD, Yapi Kredi Senior Economist Hasan Ersel said his bank has seen some progress in the real economy, though he only expects 4 percent growth this year. (Ersel conceded that absent a settlement between the Cukorova Group and BRSA, however, his own institution's embattled predicament is not sustainable past mid-year.) Some other companies are also thriving. Lezzo Industries Chairman Erol Yarar (founding Chairman of Musiad) noted that his group expects 9 percent growth in sales this year and plans significant new investments, while AKBank CEO Kurtul noted that the bank is doing well and is working to increase market share in key product lines. Both reminded us, however, that beyond the current range of macro issues facing AK, there are a whole range of structural impediments in the Turkish economy that hinder business and discourage investment. These, they argued, will have to be addressed before Turkey is able to achieve truly sustainable and balanced growth.

17. (C) Iraq: Concern about Iraq's impact on Turkey's own economy was more muted than recent alarmist press statements led us to expect. Noting that damage estimates are clearly exaggerated, Ersel quipped that they prompted him to wonder whether the U.S. was shifting its sights and planning to attack Turkey rather than Iraq. Yarar too downplayed the issue, judging that "the thought is worse than the reality." There was concern, however, particularly from market players that the perception that the U.S. and IMF would not permit Turkey to fail is creating a "moral hazard" and contributing to slippage on economic reform and fiscal discipline.

18. (C) Comment: Gul's statement came late in our day of meetings and was only addressed by Bender analysts, who judged it positive but insufficient. That view has largely been echoed over the last two days by other market analysts. But whatever the doubts about the specific figures (and there are many), there is at least relief that AK appears to have gotten the market's message at some level. Whether the reform contingent is capable of building on that start remains to be seen. Many in the markets have their doubts. End comment.

ARNETT